

Mercantile Bank Ltd., Bombay v. Commissioner of Income Tax, Bombay City-III

Civil Appeal No. 310 of 2001 / Civil Appeal No. 311 of 2001

[2006] Supp. 1 SCR 628 | 2006-05-01

For AY 1978-79, was doubtful-advance interest carried to an interest suspense account taxable, and could the employer claim separate in-service and former-employee salary limits when an employee retired during the same previous year?

119(1) | 40A(1) | 40A(5)(a)(i) | 40A(5)(c)(i) | 40A(5) Explanation 2(a) | 40A(6) | 17(1),(3) | 36(1)(vii) | 36(2) | 40(c)

2 judges | Ruma Pal, J. | Dalveer Bhandari, J.

Assessment years: 1978-79

Mixed result under historical circulars and an omitted salary provision

The bank won on AY 1978-79 doubtful-loan interest but lost its claim to two salary limits; both appeals were only partly allowed. The applicable 1952 circular differs from the procedure for AY 1979-80 onward. The 40A(5)/(6) caps were later omitted from 1 April 1989. This is not a current NPA, write-off or payroll-cap ruling. Comprehensive later treatment, current-law applicability and 2025 mapping remain not_verified.

01 FACTS OF THE CASE

The bank's main appeal concerned AY 1978-79 and two questions. The first was taxability of interest on doubtful advances credited to an interest suspense account. The second was whether, on an employee's retirement during the previous year, section 40A(5) supplied one deduction limit for amounts received in service and another for amounts received as a former employee. The Bombay High Court answered both against the bank on 9 March 1999. The bank appealed in CA 310/2001; CA 311/2001 was heard with it and received a separate concluding disposition (physical 3/SCR 630 C-H; physical 10/SCR 637 E-F).

The Court supplies no interest amount, employee-by-employee salary computation or date of a particular retirement. The three-year non-recovery history and AY 1981-82 in its discussion are facts of UCO Bank, not additional findings about this bank's AY 1978-79. The Rs. 5,000-per-month and Rs. 60,000 figures are the historical statutory salary limits at issue; the Rs. 72,000 figure appears in the comparison with the first proviso, not as the answer to the main salary question.

Source: [reported judgment / paragraphs SCR 630C-H: assessment year, two questions and appeals / PDF pages 3 / judicial text](#)

02 DISCUSSION BY THE HON'BLE COURT

On doubtful-loan interest, Ruma Pal J. first traced the competing views in State Bank of Travancore. The minority treated objectively established unlikelihood of recovery, consistent suspense-account treatment and taxation on later realization as relevant to real income. The majority had treated accrued interest under mercantile accounting as taxable where it had not been written off, drawing on sections 36(1)(vii) and 36(2). These are accounts of the earlier judgments, not a new bad-debt deduction granted in the present case (physical 4/SCR 631 A-E).

The Court followed the later three-judge UCO Bank decision and the applicable CBDT circular history. The 6 October 1952 circular permitted interest on doubtful loans kept in suspense to be left out if the Income Tax Officer was satisfied that repayment was practically improbable. Although withdrawn in June 1978, the 9 October 1984 circular directed that taxability up to AY 1978-79 be settled under the 1952 circular; its different procedure operated from AY 1979-80. The Court expressly said that newer procedure was irrelevant to the present appeal. It relied on UCO Bank's treatment of the beneficial circulars as binding on departmental authorities under 119 and held that this AY 1978-79 had to be dealt with under the 1952 circular. The High Court's contrary answer based on Travancore was therefore incorrect (physical 4-6/SCR 631 F-633 A). The condition concerning real recovery prospects remains part of the stated circular setting; mere use of a suspense ledger is not presented as a universal exclusion.

On salary, the historical section 40A(5)(a)(i) disallowed expenditure beyond the applicable clause (c) ceiling. The reproduced (c)(i) allowed Rs. 5,000 for each month or part of employment in India and stated Rs. 60,000 for a former employee who ceased or had ceased employment during that or an earlier previous year. The bank urged the Calcutta High Court's Hindustan Motors approach: separate limits for the in-service and post-retirement portions. Bombay had rejected that reading and treated salary, including terminal benefits, as subject to one limit (physical 6-8/SCR 633 B-635 D).

The Supreme Court agreed with Bombay. Separate limits could produce a Rs. 60,000 salary allowance plus a further Rs. 60,000 for retirement on the last day of the year, making the limit vary with retirement timing. The reference to one amount and to a person who ceases employment covered retirement within the very year under consideration. Explanation 2(a) adopted section 17's salary meaning with specified modifications, including omission of the word perquisites in 17(1)(iv) and of 17(1)(vii). Wages and terminal salary benefits therefore did not generate two separate salary limits (physical 8-9/SCR 635 E-636 G).

The absence of the word aggregate from the salary clause did not justify doubling it. The first proviso to 40A(5)(a) and 40A(6) used aggregation because they combined different types of expenditure or fees; the relevant salary provision addressed one amount of salary. The Court rejected Hindustan Motors' competing construction and affirmed one salary ceiling for the previous year. This is not a holding that every perquisite or every separately regulated payment falls within the same salary definition (physical 9-10/SCR 636 G-637 D).

02 DISCUSSION BY THE HON'BLE COURT

Source: [reported judgment / paragraphs SCR 631A-633H: interest and historical provisions / PDF pages 4, 5, 6 / judicial text](#); [reported judgment / paragraphs SCR 634A-637D: salary ceiling and competing constructions / PDF pages 7, 8, 9, 10 / judicial text](#)

03 JUDICIAL DECISION

CA 310/2001 was partially allowed: the High Court's answer taxing the doubtful-loan interest was rejected under the applicable 1952 circular/UCO Bank reasoning; its answer against separate salary limits was affirmed in Revenue's favour. There was no order as to costs. The Court then expressly partially allowed CA 311/2001, also without costs, in view of its judgment in CA 310/2001 (physical 5-6/SCR 632 G-633 A and physical 10/SCR 637 D-F).

Source: [reported judgment / paragraphs SCR 632G-633A: interest answer / PDF pages 5, 6 / judicial text](#); [reported judgment / paragraphs SCR 637D-F: salary answer and both partial allowances / PDF pages 10 / judicial text](#)

04 OUTCOME / IN WHOSE FAVOUR

In whose favour: Mixed: bank on doubtful-loan interest; Revenue on the single historical salary ceiling

Both CA 310/2001 and CA 311/2001 partially allowed; no order as to costs in either

Final answers on both statutory issues, with separate companion-appeal disposal

Historical AY 1978-79 circular treatment; no present-day NPA rule, blanket cash-basis entitlement or independent bad-debt write-off allowance. Salary holding concerns the then 40A(5) text; companion appeal adds no separate factual finding.

Source: [reported judgment / paragraphs SCR 637D-F: both appeals and costs / PDF pages 10 / judicial text](#)

05 AKHB REVIEW POINT

Keep the two outcomes separate. For interest, identify the lender, assessment year, recovery evidence, ledger treatment and operative circular. The earlier UCO Bank original was freshly checked on a bounded basis at physical 7-8/SCR 641-642. It confirms that the 1952 circular governed up to AY 1978-79 and that the 1984 three-year non-recovery procedure applied from AY 1979-80. Applying that later test to Mercantile's own AY 1978-79 would collapse the distinction the Court expressly preserved. The circular texts here were verified through judicial quotations; separately issued original circulars were not obtained.

For salary, retirement within a year did not create a second salary allowance under the applicable 40A(5). Do not present the Rs. 5,000/Rs. 60,000 amounts as current payroll caps, or import the first proviso's Rs. 72,000 aggregate into this answer. The 2011 Department of Revenue-hosted compilation, physical 303/printed 1.262, records omission of 40A(5) and (6) from 1 April 1989. The official Department's combined explanatory notes, paragraphs 6.11-6.12, corroborate the omission and AY 1989-90 effect, while preserving the distinct role of unreasonable-payment disallowance under 40A(2).

A further bounded check of complete section 43D in that 2011 compilation, physical 326-327/printed 1.285-1.286, shows a later statutory regime for specified lenders and prescribed bad/doubtful-debt categories, with taxation on profit-and-loss credit or actual receipt, whichever is earlier. Its footnote records original insertion from 1 April 1991 and substitution from 1 April 2000. This is a historical version check, not a current section 43D, NPA, RBI or prescribed-rule opinion. No direct later adverse judicial treatment of Mercantile was independently established in the targeted discovery. Comprehensive later treatment, current-law applicability and Income-tax Act, 2025 mapping remain not_verified.

Source: [earlier judgment bounded circular comparison / paragraphs SCR 641A-642B: quoted circular chronology and year boundaries / PDF pages 7, 8 / earlier judicial text: official department hosted historical statutory compilation / paragraphs 40A\(5\)/\(6\) omission entries and footnotes 51-52 / PDF pages 303 / historical statutory compilation; official department hosted historical statutory compilation / paragraphs Complete historical later 43D and footnote 75 / PDF pages 326, 327 / historical statutory compilation; official department explanatory circular html / paragraphs Combined explanatory notes, part IV, paragraphs 6.11-6.12 / official explanatory text](#)

DETAILED DISPOSITION AND CONNECTED GROUPS

Issue outcomes

1.

Issue: Doubtful-loan interest for AY 1978-79

Outcome: Bank succeeds; 1952 circular governs, and High Court's contrary answer is rejected

2.

Issue: Separate in-service and former-employee salary ceilings

Outcome: Revenue succeeds; one historical salary limit, not two

Proceeding outcomes

1.

Case number: Civil Appeal No. 310 of 2001

Outcome: Partially allowed on the two-issue split; no order as to costs

2.

Case number: Civil Appeal No. 311 of 2001

Outcome: Partially allowed in view of CA 310/2001; no order as to costs

Costs: No order as to costs in either appeal

ADDITIONAL STATUTORY CONTEXT, NOT SEPARATE HOLDINGS

Actual issues are doubtful-loan interest under the historical circular/119 scheme and the salary deduction ceiling under 40A(5). Sections 36(1)(vii)/36(2) describe the Travancore majority's bad-debt reasoning; this is not a separate grant of bad-debt deduction. Section 40(c)/40A(6) and the first proviso are aggregation comparisons. The source's isolated (c)(ii)/45A references are flagged rather than treated as distinct holdings.

JUDICIAL AUTHORSHIP AND SEPARATE OPINIONS

Ruma Pal, J.

ACT IDENTIFIED IN THE REVIEWED SOURCE

Income-tax Act, 1961

SPECIFIED LATER TREATMENT CHECKS AND THEIR LIMITS

1.

Authority: UCO Bank, 13 May 1999

Relationship: earlier adopted authority bounded circular verification not later treatment

Result: Judicial quotations confirm different 1952 and 1984 circular procedures and the AY 1978-79/1979-80 divide.

Source pinpoints

1.

Source url: [Open cited source](#)

Pdf pages: 7; 8

Paragraphs: SCR 641A-642B

Source role: earlier judicial text

Limit: No separate original circular acquisition or whole-case rereview; not a new public UCO note.

2.

Authority: Department-hosted 2011 compilation and combined explanatory notes

Relationship: statutory version limit not overruling

Result: 40A(5)/(6) omission effective 1 April 1989 and later historical 43D regime verified on the bounded sources stated.

Source pinpoints

1.

Source url: [Open cited source](#)

Pdf pages: 303

Paragraphs: 40A(5)/(6) omission entries and footnotes 51-52

Source role: historical statutory compilation

2.

Source url: [Open cited source](#)

Pdf pages: 326; 327

Paragraphs: Complete historical later 43D and footnote 75

Source role: historical statutory compilation

3.

Source url: [Open cited source](#)

Pdf pages:

Paragraphs: Combined explanatory notes, part IV, paragraphs 6.11-6.12

Source role: official explanatory text

Limit: The amending-Gazette chain, prescribed rules, later amendments, direct judicial treatment and current applicability are unverified.

OTHER STATUTORY PROVISIONS AND THEIR SEPARATE SCOPE

CBDT circular dated 6 October 1952; CBDT withdrawal dated 20 June 1978; CBDT circular dated 9 October 1984; Later section 43D and omission of 40A(5)/(6): bounded version checks only

DATED OFFICIAL STATUTORY HTML COMPARISONS AND READING LIMITS

1.

Kind: official department explanatory circular html

Title: Department-hosted combined explanatory notes, Direct Tax Laws (Amendment) Act, 1987-IV, paragraphs 6.11-6.12

Url: [Open cited source](#)

Full document read: False

Full judgment text read: False

Full bounded judicial text read: False

Bounded read complete: True

All document text read: False

All document images read: False

Read bounds: Live official page opened and targeted paragraphs 6.11-6.12 read, rendered text lines 2388-2395. Page title is Circular No. 545 dated 24 September 1989 but the page combines explanatory notes for Circulars 516/545/549/551; do not assign this entire combined text solely to Circular 545. Reliance only on omission of 40A(5)/(6) and AY 1989-90 effect. No HTML image review needed, no complete page or amending Act review.

Local evidence: auxiliary/circular_explanatory_web_capture.json

Provenance: Official department HTML opened successfully on 5 October 2026. Tool text capture retained for audit; not a signed circular PDF.

SOURCE & VERIFICATION

Hon'ble Supreme Court source PDF (reported judgment)

Identified source rendition: 10 PDF pages; SHA-256 bc0ccc2714680af7fb2091a5c66bea6d2bf41a98840e18f334da1399310ed38b. Original bytes preserved. Entire ten-page report read in text and all ten images. Title/editorial material physical 1-3/SCR 628-630 B; appellate recital and appearances at physical 3 C-E. Ruma Pal J. judicial text starts physical 3/SCR 630 E and ends physical 10/SCR 637 F. One opinion with separate concluding disposition for CA 311/2001; no adjacent case. Statutory/case quotations distinguished from the Court's reasoning.

Open cited source rendition

full primary text read: True; all primary page images reviewed: True; source integrity verified: True; actual statutory scope verified: True; all listed proceedings accounted for: True; comprehensive later treatment verified: False; current law verified: False; mapping 2025 verified: False; independent QA complete: True; parent full prose approval: True

Printed SCR heading, date, bench and complete proceedings checked against primary images. Catalogue INSC identifier not independently authenticated. Judicial paragraphs are unnumbered; physical-page/SCR-band pins used.

The body cites UCO Bank as 237 ITR 889 at SCR 631 F, while the headnote prints 237 ITR 859. The note relies on the identified retained UCO Bank original and does not silently authenticate the inconsistent reporter pinpoint.; SCR 635 G prints 40A(5)(c)(ii) once, but the salary provision reproduced at 633 G-H and the following sentence at 635 H use (c)(i). The note identifies the actual reproduced salary clause and flags the slip.; SCR 635 B prints 45A(c)(i) in recounting Bombay's reasoning; it is not a separate statutory holding.; The headnote labels the Kerala Travancore decision overruled. The body resolves this appeal through UCO Bank and the circular chronology; no new freestanding overruling of the Supreme Court's Travancore majority by this two-judge bench is asserted.; Hindustan Motors' double-limit construction is rejected in the body. The headnote's overruled label is distinguished from the Court's actual reasons.; No interest amount, individual retirement date or separate assessment year for CA 311/2001 is supplied. The three-year non-recovery facts and AY 1981-82 belong to UCO Bank.; The section 17 salary extract includes source repetition in the provident-fund wording; no independent provident-fund holding is inferred.; Section 36 bad-debt citations occur in the historical Travancore discussion; interest recognition and a bad-debt write-off claim remain distinct.; The bounded UCO Bank comparison itself prints 6th October 1984 once at SCR 642 B, while the circular quotation and repeated surrounding references at SCR 641 E-H and 642 A identify 9 October 1984. The isolated slip is not propagated.

AY 1978-79 is expressly stated at the start of the main judgment. No separate year or additional factual history is supplied for CA 311/2001. AY 1981-82 belongs to UCO Bank; AY 1979-80 marks the different circular procedure.

Main appeal from Bombay High Court judgment/order dated 9 March 1999 in Income Tax Reference 25/1987. CA 311/2001 is separately disposed of by applying the judgment in CA 310/2001, without separate factual recital.

STATUTORY SCOPE

No Income-tax Act, 2025 crosswalk, commencement/savings verification or automatic carryover. Complete amendment history and present applicability remain unverified.

LATER TREATMENT

Source checked 2026-10-05. Only the expressly recorded bounded statutory/earlier-authority comparisons are verified. Targeted discovery did not establish direct later judicial treatment of this decision. This is not a finding that no such treatment exists. Comprehensive later treatment, current-law applicability and 2025 mapping remain not_verified.

IDENTIFIED SOURCE LINKS

[reported judgment - PDF pages: 10](#)

SHA-256: bc0ccc2714680af7fb2091a5c66bea6d2bf41a98840e18f334da1399310ed38b

[earlier judgment bounded circular comparison - PDF pages: 14](#)

SHA-256: 8f8b72f6fe79aaa2fac76cb161d4a039b60a5f26961d38660a077297c492415d

[official department hosted historical statutory compilation - PDF pages: 1251](#)

SHA-256: 1ec6e4c38dc1d524d1d40b1fd35d13ac1336c8fc549cef2af1bf723a999c822b

[Department-hosted combined explanatory notes, Direct Tax Laws \(Amendment\) Act, 1987-IV, paragraphs 6.11-6.12](#)

AI DISCLOSURE

AI-assisted research checked against the identified source. Extraction, interpretation or omission errors remain possible. Source review does not mean independent approval by a practising professional. Verify every material statement against the complete original judgment.

PROFESSIONAL DISCLAIMER

General research information only; not legal or tax advice, a certified judgment or a substitute for the full order. Applicability depends on facts, assessment year, statutory version and jurisdiction. Subsequent treatment is unverified unless identified sources are expressly stated. Downloading does not create a professional engagement. Obtain case-specific advice before reliance.